



Why the Canadian Banks Are Poised to Reach All-time Highs After This Earnings Season

Description

Bank earnings season is well underway, with **Canadian Imperial Bank of Commerce** ([TSX:CM](#))([NYSE:CM](#)), **Royal Bank of Canada** ([TSX:RY](#))([NYSE:RY](#)), **Bank of Montreal** ([TSX:BMO](#))([NYSE:BMO](#)), and **Bank of Nova Scotia** ([TSX:BNS](#))([NYSE:BNS](#)) releasing their numbers for the third quarter of 2018. So far, despite slowing loan conditions, the Canadian banks have shown resiliency in their earnings even in the face of tighter credit conditions here and in the United States.

Of the four out of six majors that have reported, all have beaten the Street's consensus on earnings per share (adjusted to exclude to one-time items) basis, thanks to across-the-board solid performances in their personal and commercial banking segments (for further reading check out Ambrose O'Callaghan's [comparison](#) of RBC's and CIBC's third-quarter numbers).

Slower lending offset by higher margins

Household credit in Canada has begun to slow with increasing interest rates and tighter mortgage regulations. However, the Bank of Canada's contractionary monetary policy has also led to an uptick in net interest margins, otherwise known as NIMs, or how much the banks make on their loans versus how much they pay to borrow.

This rise in NIMs has largely offset the declining lending volume, with CIBC, RBC, BNS, and BMO reporting year-over-year increases in domestic banking segment profits of 14%, 11%, 8%, and 5%, respectively. Moreover, this NIM expansion is expected to continue into 2019 if the market's expectation of one further rate hike this year comes to fruition.

Along with the rate hike, there are other signs that the Canadian financial system continues to exhibit strength going into next year. For example, numbers from the Bank of Canada's July Monetary Policy Report point to an economy that's performing close to capacity with CPI inflation oscillating in the 2-2.5% band through to the second half of 2019, and real GDP averaging 2% for the next two years.

Furthermore, household consumption is also expected to remain robust, though at a more subdued

pace than what we've seen in 2017, powered by a healthy labour market and steady wage growth.

On the international front, the export sector and business investments should also provide a tailwind, even in the face of potential tariffs from the United States, thanks to rising commodity prices and foreign demand. With these factors in mind, the economic conditions are pointing to a gradual rate hike path here in Canada and an overall conducive macroeconomic environment for the Canadian banks.

But is it just a NIM story for the Schedule I names?

Well, not entirely. There are other drivers as well that point to a bullish case for the Big Six. For example, income-oriented investors should be pleased by the recent dividend hikes from CIBC, BNS, and RBC (the former two names are currently yielding over 4.4%).

However, growth-oriented drivers can also come by way of continued international expansion, such as BNS's increasing exposure to the [Latin American markets](#), particularly in Chile, Columbia, and Peru, and BMO and TD's American segments.

With TD and **National Bank** coming up on deck later this week, expect a pair of beats and raises that should lift the rest of the sector. Overall, if economic conditions continue their steady upward trend, the banks should have no problem taking out their all-time highs. Personally, I am recommending CIBC thanks to its dividend hike and strong domestic banking results.

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3. NYSE:CM (Canadian Imperial Bank of Commerce)
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5. NYSE:TD (The Toronto-Dominion Bank)
6. TSX:BMO (Bank Of Montreal)
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